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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959.

No. 905.

SECURITIES AND EXCHANGE COMMISSION,

Petitioner,

v.

LEA FABRICS, INC., *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF OF RESPONDENTS, LEA FABRICS, INC., DEBTOR, UNSECURED CREDITORS' COMMITTEE AND RECEIVER OF DEBTOR OPPOSING CERTIORARI.

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TABLE OF CONTENTS.

	PAGE
JURISDICTION	1
OPINION BELOW	1
QUESTION PRESENTED	2
STATUTE INVOLVED	2
STATEMENT	3
ARGUMENT:	
POINT I.—The decision of the court below refusing to vacate its opinion and judgment was correct....	7
A. This petition of the S. E. C. for certiorari seeks to review an order of the Court of Appeals properly entered by that Court.....	7
B. The cases cited by the S. E. C. lend no support to its petition for a writ of certiorari....	8
C. The fact that the S. E. C. has an opinion on the books not to its liking furnishes no reason for the granting of the writ applied for....	10

Index to Appendix.

Answer of Lea Fabrics, Inc., Debtor, Unsecured Creditors' Committee, and Receiver of the Debtor, to Petition of Securities and Exchange Commission for Rehearing	A-1
Transcript of Hearing before Referee February 5, 1960	A-5

Table of Cases.

	PAGE
United States v. *Munsingwear*, 340 U. S. 36, at pp. 39 and 40, 95 L. Ed. 36	8, 9

Statutes.

R. S. 14:14-3	3
28 U. S. C. 1254(1)	1
Bankruptcy Act, 11 U. S. C. 728,	
Section 328	2, 3, 4
Chapter XI	3, 10
Section 321	9

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Jurisdiction.

The Order of the United States Court of Appeals for the Third Circuit sought to be reviewed was entered on March 23, 1960 (App. annexed to petition p. 20). The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

Opinions Below.

The United States Court of Appeals for the Third Circuit filed no opinion in connection with its order of March 23, 1960 denying petitioner's motion to vacate on the ground of mootness its earlier judgment affirming the order of

the District Court. The opinion of the Court of Appeals upholding the order of the District Court on the merits is reported in 272 F. 2d 769, and is set forth at pages 13-18 of appendix to petition. The oral opinion of the District Court is not reported, but is set forth in petitioner's appendix to its brief in the Court of Appeals (35a-43a).[1]

Question Presented.

Whether the United States Court of Appeals for the Third Circuit properly refused to vacate its opinion and judgment affirming an order of the District Court sustaining the propriety of a proceeding under Chapter XI of the Bankruptcy Act after the entry by the District Court of an adjudication in bankruptcy.

Statute Involved.

11 U. S. C. 728 (Section 328 of the Bankruptcy Act):

> "The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under chapter 10 of this title, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of chapter 10 of this title for the filing of a debtor's petition or a creditors' petition, under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with section 532 of this title, such amended petition or creditors' petition shall

[1] Numerals followed by the letter "a" refer to the appendix of the proceedings in the United States Court of Appeals for the Third Circuit.

thereafter, for all purposes of chapter 10 of this title, be deemed to have been originally filed under such chapter."

Statement.

The debtor, a Delaware corporation, all of whose visible assets and whose principal place of business were in the City of Newark, County of Essex, and State of New Jersey, on January 21, 1959 filed a proceeding for an arrangement under Chapter XI of the Bankruptcy Act (24a). Prior to that, on July 7, 1958, a creditor of the debtor had filed a complaint in the Chancery Division of the Superior Court of New Jersey seeking the appointment of a receiver for the debtor under the insolvency provisions of the Corporation Act of the State of New Jersey. On November 10, 1958 the Superior Court of New Jersey adjudged the debtor corporation insolvent within the meaning of the Statutes of the State of New Jersey, R. S. 14:14-3, and appointed a Statutory Receiver pursuant to the said Statute for the assets and affairs of the debtor corporation (24a).

The debtor proposed a plan of arrangement in the Chapter XI proceeding, which was approved by its creditors (25a). In essence the plan provided for (a) payment of all priority claims in full, (b) payment of all administration expenses in full, and (c) payment to all general unsecured creditors of 20% of their claims as finally approved and allowed.

On September 23, 1959, the Securities and Exchange Commission (S. E. C.), pursuant to Section 328 of Chapter XI, 11 U. S. C. 728, moved to intervene and to dismiss the Chapter XI proceeding unless the debtor's petition was amended to comply with the requirements of Chapter X (8a-14a).

When the debtor and its counsel, the Receiver, the attorney for the Receiver, and the attorney for the Creditors' Committee arrived in Court a few minutes before two o'clock on September 23, 1959, the date and time set by the Referee for the hearing on the confirmation of the plan of arrangement proposed by the debtor and approved by creditors, they were met by the attorneys for the S. E. C. These attorneys announced that at one o'clock in the afternoon, an hour before the hearing on the confirmation of the plan, they had filed with the Clerk of the United States District Court for the District of New Jersey a motion for intervention, and had applied for an order to show cause under Section 328 of the Bankruptcy Act (26a). The hearing before the Referee was immediately adjourned. All counsel thereupon appeared before Judge Wortendyke, Judge of the United States District Court on the motion of the S. E. C. (26a). All parties agreed that the motion to intervene should be granted at once and the debtor, the attorney for the Receiver, and the attorney for the Creditors' Committee urged that a prompt hearing on the order to show cause be had, because of the large sum of money that was tied up and that there was reason to believe that the money might not be available if any lengthy litigation over the motion of the S. E. C. ensued.

Judge Wortendyke set the hearing down and on October 2, 1959 heard the matter for almost the entire day. At the conclusion of the hearing he denied the application of the S. E. C. under Section 328 of the Bankruptcy Act, and discharged the order to show cause which he had granted. An order to that effect was entered on October 14, 1959 (42a), from which order an appeal was taken by the S. E. C. to the United States Court of Appeals for the Third Circuit. The order was affirmed by that Court on December 8, 1959. It is this judgment which the S. E. C. now asks to have vacated.

Thereafter the S. E. C. filed its petition for rehearing. An answer to the petition for rehearing was filed by the respondents herein (App. *infra*, pp. A-1 to 4). On January 5, 1960 the Court denied the motion and the mandate of the Court was then issued on January 11, 1960. An order on the mandate was then issued. No application for a writ of certiorari was filed by the S. E. C. to review the order of the Third Circuit Court of Appeals entered on December 8, 1959 affirming the order of the District Court.

At the hearing before the Referee on confirmation of the plan on September 23, 1959, and subsequently before Judge Wortendyke on October 2, 1959, the debtor stated that the cash necessary to consummate the plan of arrangement was available (26a).

In an affidavit of Fred S. Payne, filed with Judge Wortendyke in opposition to the motion of the S. E. C. he stated, as President of the debtor corporation:

> *"The cash necessary to pay creditors' claims is being advanced to the Debtor without any security or strings whatsoever. On confirmation of the Chapter XI Plan, therefore, the Debtor's capital structure will remain absolutely simple and unchanged. Neither the rights of creditors nor stockholders will be impaired.* (Italics supplied.)
>
> "Said Plan bears no relationship to and is not dependent on management's proposals and plans for the Debtor's future, as suggested by the Commission" (32a).

Judge Goodrich, in his opinion sustaining the order of the District Court, stated:

> "After several months an arrangement was proposed and agreed to by the necessary majority of the creditors. Under this arrangement the unsecured creditors are to receive twenty cents on the dollar.

There is to be a sufficient fund ($300,000). to be available for this purpose obtained by management on an unsecured loan." (App. annexed to petition, p. 14.) (Italics supplied.)

The arrangements of the debtor outlined by the S. E. C. at page 4 of its petition herein were not the arrangements through which the debtor proposed to effectuate its plan of arrangement. The debtor's arrangements to effectuate its plan of arrangement were to borrow $300,000.00 on an unsecured basis with no strings attached, as outlined by Mr. Payne in his affidavit, *supra*, and as found by Judge Goodrich in his opinion, *supra*.

At a hearing before the Honorable William H. Tallyn, Referee in Bankruptcy, before whom the Chapter XI proceeding was pending, held on February 5, 1960, it was disclosed by the attorney for the debtor in a colloquy before the Referee, that the debtor was having difficulty in raising the funds necessary to effectuate the plan of the debtor and thus secure confirmation of such plan by the Court. In testimony given at the same hearing Mr. Fassoulis, who was the controlling stockholder of Financial Consultants, which was the largest stockholder of the debtor, in addition to being the financial advisor of the debtor, stated that prior to the S. E. C. motion the debtor had had a firm commitment for $300,000.00 to effectuate the plan, which had been lost during the period of the S. E. C. litigation (App. *infra*, p. 5).

On February 18, 1960, when it was obvious that funds needed to confirm the plan were no longer available, the Referee entered an order adjudging the debtor a bankrupt and ordered that bankruptcy be proceeded with.

ARGUMENT.

POINT I.

The decision of the court below refusing to vacate its opinion and judgment was correct.

A. This petition of the S. E. C. for certiorari seeks to review an order of the Court of Appeals properly entered by that Court.

It must be clearly kept in mind at all times that the S. E. C. seeks a review in this Court of the order of the United States Court of Appeals for the Third Circuit entered March 23, 1960, denying the motion of the S. E. C. to vacate its opinion and order entered on December 8, 1959, affirming the decision of the District Court. No review of this latter order is sought here. The S. E. C. did not file any petition for certiorari to review said order.

Instead, the S. E. C. chose to file a petition with the Court of Appeals asking it to vacate its opinion and judgment on the ground that the case had become moot, because on February 18, 1960 the Referee in Bankruptcy had decided that the debtor should be adjudicated a bankrupt. Prior to this petition of the S. E. C. the Court of Appeals had issued its mandate on January 11, 1960. Thereafter the District Court entered its order on the mandate on January 12, 1960. We submit that the Court of Appeals in entering its order of March 23, 1960 exercised sound discretion in refusing to recall its mandate and vacate its opinion and judgment.

No possible question of mootness existed at the time the Court of Appeals handed down its opinion and rendered its judgment.

B. The cases cited by the S. E. C. lend no support to its petition for a writ of certiorari.

All of the cases cited by and relied upon by the S. E. C. in its petition here were called to the attention of the Court of Appeals by the S. E. C. in its brief before that Court upon its motion to vacate the decision and judgment of that Court. A careful analysis of these cases shows that they lend no support to the petition of the S. E. C.

One of such cases relied upon by the S. E. C. is *United States* v. *Munsingwear*, 340 U. S. 36, at pp. 39 and 40, 95 L. Ed. 36. Justice Douglas, speaking for this Court, at page 39 said:

> "The established practice of the Court in dealing with a civil case from a court in the federal system which has become moot while on its way here or pending our decision on the merits is to reverse or vacate the judgment below and remand with a direction to dismiss. That was said in Duke Power Co. *v.* Greenwood County, 299 U. S. 259, 267, 81 L. Ed. 178, 182, 57 S. Ct. 202, to be 'the duty of the appellate court.' That procedure clears the path for future relitigation of the issues between the parties and eliminates a judgment, review of which was prevented through happenstance. When that procedure is followed, the rights of all parties are preserved; none is prejudiced by a decision which in the statutory scheme was only preliminary."

In the case at bar there are no facts which bring the case into the established practice of the Court in dealing with civil cases from a Court in the Federal system which has become moot while on its way to this Court or pending the decision of this Court *on the merits*. There was no question of mootness before the Court of Appeals at the time its order was entered affirming the District Court. As

hereinbefore pointed out, no petition for a writ of certiorari has been applied for by the S. E. C. addressed to the Third Circuit Court of Appeals to review its order affirming the District Court. This decision cannot, therefore, be reviewed by this Court on the merits.

Further, in the case at bar such vacation procedure is not necessary to clear the path in case of future litigation of issues between the debtor and the S. E. C. There are no rights between the parties to the action which are preserved, or which need preserving by such a procedure. The S. E. C. has not shown in its petition for certiorari in any way how or why it will be prejudiced if the decision of the Court of Appeals is permitted to stand. Unlike the situation in *Munsingwear, supra*, the refusal to vacate the judgment here will not hamper the S. E. C. if there is future litigation between the parties here because necessarily there will be an entire new proceeding and a different set of facts if the debtor at any time in the future files a new Chapter XI proceeding for relief under that Section of the Bankruptcy Act.

This is indicated by Section 321 of the Bankruptcy Act, 11 U. S. C. 721 which provides as follows:

> "A debtor may file a petition under this Chapter in a pending bankruptcy proceeding either before or after his adjudication."

The procedure desired by the S.E.C., of having this Court vacate the opinion and judgment of the Court of Appeals, clears no path for future relitigation of the same issues between the parties. Nor would the vacation of the opinion and judgment by this Court preserve the rights of all parties to the proceeding, since there are no rights to be preserved, either past or future. No one is prejudiced by the decision of the Court of Appeals.

C. The fact that the S. E. C. has an opinion on the books not to its liking furnishes no reason for the granting of the writ applied for.

At page 9 of its brief, the S.E.C. states:

> "In the present case, the determination of the court below, if not vacated, may well affect the result of other cases under Chapter XI of the Bankruptcy Act."

We submit that the determination of the Court below and its effect upon the result of other cases under Chapter XI of the Bankruptcy Act, furnishes no valid reason for vacating the decision of the Court of Appeals. We firmly believe that the only reason that the S.E.C. seeks to vacate at this time the opinion and judgment of the Court of Appeals, is because it has an opinion on the books which is not to its liking. This is certainly no reason why this Court should vacate the opinion and judgment of the Court of Appeals. Quite the contrary. An appraisal of the case, we believe, must lead to a denial of the petition of the S.E.C. to review the order of the Court of Appeals entered March 23, 1960.

Conclusion.

For all the foregoing reasons, respondents respectfully urge that the writ of certiorari be denied.

Respectfully submitted,

SAMUEL M. COOMBS, JR.,
Attorney for Receiver,
Respondent.

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APPENDIX.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT.

No. 13054.

IN THE MATTER

of

LEA FABRICS, INC.,

Debtor,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Appellant.

APPEAL FROM ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY.

Answer of Lea Fabrics, Inc., Debtor, Unsecured Creditors' Committee, and Receiver of the Debtor, to Petition of Securities and Exchange Commision for Rehearing.

On Wednesday, December 23, 1959, the mandate of this Court would have issued to the United States District Court for the District of New Jersey, as of course, fifteen days having expired after the date of entry of final judgment in the above entitled appeal on December 8, 1959. On that date, December 23, 1959, the Securities and Exchange Commission (S. E. C.) filed its petition for rehearing herein, and the interested parties who are now answering such petition were notified by telephone by Mr. Kiva Berke, of the S. E. C., on that day that such petition was to be filed and that copies of such petition were being mailed special delivery from Washington to all interested parties late in the afternoon of

that date Not having received the copies of the petition for rehearing, counsel for the Receiver called the Clerk of this Court on December 24, 1959, and was advised that such petition had been filed on December 23, 1959. Later in the day, on December 24, 1959, copies of the petition were received by the interested parties now answering said petition.

This Court noted, at page 4 of its opinion, that:

> "Not the least of the considerations which prompt approval of the trial judge's exercise of discretion is the situation of this corporation."

This Court then went on to review the status of the corporation at the time the motion of the S. E. C. was filed to dismiss the Chapter XI proceeding unless the petition therein was amended to comply with the requirements of Chapter X (Sec. 328 of the Bankruptcy Act, 11 U. S. C. A. Sec. 728 (Sup. 1958)). It must be remembered that the S. E. C. filed its motion on the day on which the plan of arrangement under the Chapter XI proceeding was to be approved by the Referee, and upon the day on which the $300,000.00 necessary to effectuate such plan of arrangement was to be deposited with the Receiver by the debtor corporation.

As this Court pointed out at page 3 of its opinion:

> "The plan has been agreed to by the unsecured creditors and the priority creditors, including tax claimants, * * *"

Not only creditors, but stockholders of the corporation are vitally interested in seeing the plan approved by proper order of the Referee, and almost daily are evincing such interest by telephone calls to counsel for all of the interested parties answering this petition for rehearing and the Receiver of the debtor corporation. Every day that such order is delayed the rights of creditors, secured and unsecured, stockholders, and the debtor corporation, under the proposed plan of arrangement, are gravely endangered.

The hearing on the approval of the proposed plan is being adjourned from week to week before the Referee until this appeal is disposed of.

The S. E. C. states, in paragraph 2 of page 1 of its petition:

> "The opinion describes only the formal arrangement to be consummated in the Chapter XI court. It ignores the complicated series of transactions which the debtor had planned to enter into outside the court, including the purchase and sale of various assets and recapitalization of its stock. (See our main brief, pp. 5-6). It may be that this Court made no reference to those transactions because the debtor contended that they had been abandoned."

This is basically the reason given by the S. E. C. why it desires a rehearing. In the final paragraph of its petition, on page 3, the S. E. C. states:

> "• • • we believe to be essentially irrelevant the debtor's contention on this appeal (Brief, p. 5) that 'On confirmation the Debtor's capital structure was and is to remain unchanged. The rights of stockholders will not be changed or impaired.' If this Court is of the view, however, that this *contention, first advanced upon the argument below after the factual record had been completed*, casts some doubt upon our showing that in addition to the Chapter XI arrangement steps will be required to be taken affecting the rights and interests of public stockholders, then it is respectfully suggested that an appropriate course would be to remand the matter to the District Court for further evidence." (Emphasis supplied.)

That the S. E. C. is patently in error in the foregoing statement is borne out by the record below. The decision of this Court is not based upon a contention that was first advanced upon the argument below after the factual record had been completed.

The affidavit of Mr. Fred S. Payne, President of the debtor corporation, in opposition to the motion of the S. E. C. to dismiss, at 32a, is as follows:

> "The cash necessary to pay creditors' claims, is being advanced to the Debtor without any security or strings whatsoever. *On confirmation of the Chapter XI Plan, therefore, the Debtor's capital structure will remain absolutely simple and unchanged. Neither the rights of creditors nor stockholders will be impaired.* (Emphasis supplied.)
>
> "Said Plan bears no relationship to and is not dependent on management's proposals and plans for the Debtor's future, as suggested by the Commission."

The Court below, at pp. 4 and 5 of the hearing before that Court on October 2, 1959, asked questions of and received answers from Mr. Payne and his counsel, Mr. Ravin, relating to the debtor's capital structure and the fact that it would remain unchanged so that neither the rights of creditors nor stockholders would be impaired.

We respectfully submit that this Court should deny the petition of the S. E. C. for a rehearing because this Court's decision is predicated on a proper application of the law to the facts.

Respectfully submitted,

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By: NATHAN RAVIN,
A Partner,
Attorneys for the Debtor.

FURST, FURST & FELDMAN,

By: DAVID E. FELDMAN,
A Partner,
Attorneys for Unsecured Creditors' Committee.

SAMUEL M. COOMBS, JR.,
Attorney for Receiver.

Transcript of Hearing before Referee February 5, 1960 (pages 5 and 6).

"*Direct examination*

"By Mr. Ravin:

"Q. Mr. Fassoulis, what is your interest in Lea Fabrics, Inc.? A. I am the controlling stockholder of a company called Financial Consultants, which is the largest stockholders of Lea Fabrics. In addition to which I have acted as financial adviser to Lea Fabrics.

"Q. Will you tell the Court what the status of your efforts was at the time the appeal was taken from Judge Wortendyke's decision as to raising money to take this case out of court and consummate the plan of arrangement? A. We had a commitment from, a firm commitment for $300,000 which was ready to be deposited to have the company confirmed.

"Q. Yes? A. During the period of that litigation we lost the $300,000 because they looked into another situation.

"Q. You mean you lost the commitment? A. Yes."